83-653

No.

In the Supreme Court of the United States

OCTOBER TERM, 1983

LEATHERBY INSURANCE COMPANY, a/k/a WESTERN EMPLOYERS INSURANCE COMPANY,

Petitioner,

vs.

MERIT INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether this Court's decision in *Commonwealth Coatings Corp.* v. *Continental Casualty Co.* requires that an arbitration award be vacated when a neutral arbitrator has intentionally failed to disclose a "clearly not . . . trivial or insubstantial" relationship with a party to the arbitration?

2. Whether a district court's decision under Fed. R. Civ. P. 60(b)(6) to set aside its own judgment confirming an arbitration award can be reversed on the ground that "rerunning the arbitration . . . is unlikely to change the outcome"?

3. Whether a Court of Appeals may ignore the findings of a district court on the merits of a claim and substitute its own version of the facts without applying the clearly erroneous test of Fed. R. Civ. P. 52(a)?

In accordance with Supreme Court Rule 28.1, petitioner Leatherby Insurance Company, now known as Western Employers Insurance Company, hereby states that 100% of its stock is owned by Western Employers, Inc., whose stock is wholly owned by Continental Financial Services Company, which in turn is wholly owned by The Continental Group, Inc., a publicly-held corporation. A detailed listing of Leatherby Insurance Company's affiliates is provided in Appendix H.

TABLE OF CONTENTS

CITATIONS

Cases

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Petitioner Leatherby Insurance Company ("LIC") respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in this action, reversing the judgment of the United States District Court for the Northern District of Illinois. The district court had vacated its own previous judgment confirming an arbitration award and in turn had vacated the award.

OPINIONS BELOW

The July 12, 1983 opinion of the Court of Appeals, reversing the district court, is officially reported at 714 F.2d 673 (Appendix at 1-18). The district court granted petitioner's motion for relief from judgment and vacated the arbitration award in an oral opinion given in open court on September 10, 1982 (App. at 19-32) and a minute order of the same date (App. at 40). The September 10 opinion and order are not reported. The district court's oral opinion of October 15, 1982, denying respondent's motion for reconsideration, is also unpublished (App. at 33-39).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The judgment of the Court of Appeals for the Seventh Circuit was entered on July 12, 1983. A timely petition for rehearing was denied on September 12, 1983, and this petition for certiorari was filed within 90 days of that date.

STATUTES AND RULES INVOLVED

United States Arbitration Act, United States Code, Title 9, Section 10:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—. . . (b) Where there was evident partiality or corruption in the arbitrators, or either of them.

Rule 60(b), Federal Rules of Civil Procedure:

> On motion and upon such terms as are just, the court may relieve a party or his legal representative from

> a final judgment, order, or proceeding for the following reasons: . . . (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time . . . after the judgment, order, or proceeding was entered or taken.

Rule 52(a), Federal Rules of Civil Procedure:

> . . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . .

STATEMENT OF THE CASE

On December 19, 1980, respondent Merit Insurance Company ("Merit") filed a petition in the District Court for the Northern District of Illinois to confirm an arbitration award in the principal amount of $10,675,000 against petitioner Leatherby Insurance Company ("LIC") under 28 U.S.C. § 1332 and the United States Arbitration Act (9 U.S.C. § 9). LIC filed a counterclaim to vacate, modify or amend the award under 9 U.S.C. § 10 on March 9, 1981. On November 19, 1981, the district court (Kocoras, J.) confirmed the award. On May 12, 1982, LIC filed a motion for relief from that judgment under Fed. R. Civ. P. 60(b)(6).

On September 10, 1982, after a four-day evidentiary hearing, the district court set aside its own earlier judgment confirming the arbitration award pursuant to Rule 60(b)(6) and in turn vacated the award pursuant to 9 U.S.C. § 10(b) (Minute Order, App. at 40).[1] The district

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[1] For procedural reasons, this minute order was re-entered on November 4, 1982, and the appeal was taken from the order as re-entered.

court based its decision on the fact that a neutral arbitrator, Jack F. Clifford, had intentionally concealed a relationship with Merit that "was not trivial, insignificant or insubstantial" (Dist. Ct. Opn., App. at 31). On July 12, 1983, a panel of the Court of Appeals for the Seventh Circuit reversed the district court's judgment. The facts pertinent to the instant petition follow.

On October 20, 1972, Merit and LIC entered into a Reinsurance and Assumption Agreement ("reinsurance agreement"). The reinsurance agreement stated that:

> [A]ny controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . . [LX17.][2]

Pursuant to that provision, a dispute between Merit and LIC was referred to arbitration by the District Court for the Northern District of Illinois on June 20, 1977. The arbitration proceedings were supervised by the regional office of the American Arbitration Association ("AAA") in Chicago, Illinois and began with the selection of arbitrators.

The first list of proposed arbitrators was submitted to the parties by the AAA in mid-July of 1977. The name of Jack F. Clifford was included on that list. The only description of Clifford's background supplied by the AAA was the following statement: "Deals with labor and probate, also Law Instructor, CPCU Reinsurance" (LX49). Counsel for LIC made inquiries about Clifford; "there was nothing to trigger in the minds of [LIC] or its coun-

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[2] References to exhibits in the evidentiary hearing are designated as "LX ___". References to testimony in the evidentiary hearing or in the arbitration are designated by the witness' name and "HT ___" or "Arb. T ___" respectively.

sel" a need to probe more deeply into Clifford's background than they did; and they were unaware that he had a prior relationship with Merit's president (Dist. Ct. Opn., App. at 23-24), a relationship which is discussed in detail *infra*. Clifford was accepted by both parties as a neutral arbitrator.[3]

On July 25, 1977, the AAA tribunal administrator informed Clifford of his selection and directed him to advise the AAA if he had any "association with either of the parties or their representatives which would disqualify [him] from serving" (LX32). On August 26, 1977, an AAA Notice of Appointment form was sent to Clifford for execution (LX2A) along with copies of the Demand for Arbitration and the reinsurance agreement. Importantly, the AAA form included an oath to be signed by the arbitrator and specifically stated on its face—boldly highlighted in a grey-colored, rectangular area—as follows:

> It is most important that the parties have complete confidence in the Arbitrator's impartiality. Therefore, *please disclose any past or present relationship with the parties or their counsel, direct or indirect, whether financial, professional, social or other kind. Any doubt should be resolved in favor of disclosure.* If you are aware of such relationship, please describe it on the back of this form. The AAA will call the facts to the attention of the parties' counsel. [LX2A (emphasis added).]

At the time of his selection, Clifford had served as an arbitrator for the AAA twice before. He had read Section 18 of the AAA's Commercial Arbitration Rules (Clifford: HT 96), which states in part:

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[3] The other two arbitrators were party-appointed by Merit and LIC respectively, but it was agreed that they were to be treated as neutral in that they were not "expected to support or endorse a position taken by" the parties appointing them (LX37; Arb. T 290, 535).

> A person appointed as neutral Arbitrator shall disclose to the AAA any circumstances likely to affect his impartiality, including any bias or any financial or personal interest in the result of the arbitration or *any past or present relationship with the parties* or their counsel. Upon receipt of such information from such Arbitrator or other source, the AAA shall communicate such information to the parties . . . . [LX19 (emphasis added).]

From the time he received his Notice of Appointment form, Clifford knew that the president of Merit was Jerome Stern, a man under whom he had directly worked for well over two years (Clifford: HT 96; LX17). From the Fall of 1960 until shortly before the company was liquidated in the Spring of 1963, Stern was the executive vice president of Cosmopolitan Insurance Company in Chicago. His vice president for claims was Jack F. Clifford. Throughout that period, Stern supervised Clifford, and Clifford reported to Stern, answering to Stern on matters of great importance to the company (Dist. Ct. Opn., App. at 20-21, 28). This shared work experience was all the more significant because Cosmopolitan's liquidation was an "explosion" in the insurance industry that left many policy holders without insurance (Clifford: HT 135-36; Dist. Ct. Opn., App. at 21). The district court found that the Clifford-Stern relationship was "clearly not a trivial or insubstantial relationship" and "did not diminish by the passing of time" (Dist. Ct. Opn., App. at 29, 38). The court in turn found that, "because of . . . Mr. Stern's interest in Merit Insurance Company, the Clifford/Merit relationship was not trivial, insignificant or insubstantial" (Dist. Ct. Opn., App. at 31).

Despite the mandate of the AAA to disclose "any past or present relationship," Clifford made no disclosure of his relationship to Merit's president on the AAA Notice of

Appointment form (Clifford: HT 17-19). At the evidentiary hearing, Clifford attempted to excuse this failure by claiming that, when he filled out his oath, he did not know that Stern "was going to be a witness" (Clifford: HT 96). Yet Clifford took no action when Stern *did* appear as a witness on the very first day of testimony.

The AAA's Manual for Commercial Arbitrators expressly states in part:

> When parties and their witnesses assemble in the hearing room, the arbitrator may recall for the first time a past association with a person involved. Prompt disclosure at this time gives the parties an opportunity to waive their objections. [LX18.]

Notwithstanding this instruction, Clifford made no disclosure when Stern took the stand as Merit's lead-off witness and described his background, testifying at length about his experiences at Cosmopolitan (Stern: Arb. T 121-28). Nor did Clifford make any disclosure of his prior relationship with Stern during any of the approximately thirty *other* days that Stern testified. Indeed, Stern was a critical fact witness whose testimony lasted longer than any other witness for Merit in the arbitration (Clifford: HT 117-18). The district court—which had reviewed the arbitration record in detail prior to its earlier confirmation of the award—specifically found that:

> In this case, Mr. Stern was the most important, if not only, occurrence witness on the question of liability, and his credibility was a not insignificant question. [Dist. Ct. Opn., App. at 28.][4]

[4] Merit's claim in the arbitration was that it had been "defrauded" by LIC and others into entering into the reinsurance agreement. Stern's testimony that he would not have signed the agreement if he had "known" a variety of facts allegedly concealed from him by LIC (Stern: Arb. T 729-843) was an absolutely essential element of Merit's case.

Yet never at any time during the arbitration proceeding did Clifford disclose his past relationship with the president of Merit to the AAA (Angarone: HT 248-50) or to LIC (Casey: HT 480-81; Armiros: HT 457).[5] Moreover, Clifford affirmatively took steps to conceal his relationship with Stern during the arbitration and lied to the district court about the relationship during the evidentiary hearing.

During the arbitration, Clifford sent to the AAA regional office a Panel Data Sheet Update, which is used to record the background of arbitrators, and purported to list all of his "previous positions." While expressly stating on the form that he was "presently serving as arbitrator in the *Merit Mutual* v. *Leatherly* [sic] case now before AAA here in Chicago," Clifford omitted entirely his three year Cosmopolitan tenure and concealed the gap by falsely stating that he was with a law firm during those years (LX3A).[6] The district court recognized this cover-up of the Cosmopolitan connection to be significant and found that Clifford's failure to disclose his employment at Cosmopolitan on the Panel Data Sheet Update was "false and fraudulent" conduct, an "affirmative effort . . . to conceal evidence," and "deception" (Dist. Ct. Opn., App. at 24, 30, 32). The court further found that "the significance of

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[5] Nor was any disclosure made when the reading of Gerald Rotheiser's deposition testimony into the record was commenced (Arb. T 5402-03). Rotheiser, who is the vice president of Merit, had been a vice president of Cosmopolitan and officed next door to Clifford between 1961 and 1963 (Rotheiser: HT 382-83).

[6] Clifford tried to deny authorship of the Panel Data Sheet Update, but the district court rejected his denial, stating:

> I do not credit that testimony. There is no doubt in my mind and I find that 3-A was the product of Mr. Clifford and he occasioned the preparation and submission of 3-A, and he was responsible and accountable for its presentation and submission. [Dist. Ct. Opn., App. at 25.]

[the] relationship [between Stern and Clifford] and its possible effect [on his continued participation as an arbitrator] was what motivated that misdeed" (Dist. Ct. Opn., App. at 22, 30).

At the evidentiary hearing itself, Clifford testified as a court's witness and, as the district judge found, "made an intentional effort to minimize his relationship with Mr. Stern beyond what I believe the facts would support" (Dist. Ct. Opn., App. at 20). The district court did not credit Clifford's explanation of why he made no disclosure and bluntly stated, "I do not find Mr. Clifford to be a credible witness" (*id.*). Neither these findings nor any other findings of fact made by the district court were held to be clearly erroneous by the Court of Appeals.

As shown by evidence in the record, information about Clifford's prior association with Stern "was first received by Leatherby or its attorneys in April of 1982, and not before" (Dist. Ct. Opn., App. at 24). Promptly thereafter LIC filed its Rule 60(b)(6) motion.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS REJECTED THE RULE OF COMMONWEALTH COATINGS AND ITS TEACHINGS ABOUT THE ARBITRATION PROCESS.

Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145 (1968), controls this case, and the district court properly applied it to vacate the arbitration award (Dist. Ct. Opn., App. at 25-26). The Court of Appeals, however, rejected the universally accepted, prophylactic rule of that case and its teachings about the integrity of the arbitration process.

A. THE COURT OF APPEALS DECISION DIRECTLY CONFLICTS WITH THIS COURT'S DECISION IN COMMONWEALTH COATINGS.

In *Commonwealth Coatings*, this Court vacated a unanimous arbitration award because of the failure of a neutral arbitrator to disclose a prior non-trivial relationship with one of the parties. This Court held that the arbitrator's nondisclosure constituted "evident partiality" under Section 10(b) of the United States Arbitration Act (9 U.S.C. § 10) and thus required vacatur of the award. Importantly, the Court took this action even though the arbitrator in that case was "entirely fair and impartial," 393 U.S. at 151 fn. (White, J., concurring), and the arbitration award was unanimous, *id.* at 152 (Fortas, J., dissenting).

In reaching its result, this Court established a broad prophylactic rule: in order to protect the integrity of the arbitration process, awards will be vacated for vio-

lations of "the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias." 393 U.S. at 149. The Court explained the reason for this rule as follows:

> It is true that arbitrators cannot sever all their ties with the business world, . . . but we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review. [*Id.* at 148-49.]

As the concurring Justices emphasized, the arbitration process is best served "by establishing an atmosphere of frankness at the outset" and encouraging disclosure of past or present relationships with parties. 393 U.S. at 151 (White, J., concurring). If such disclosure is not made, vacatur is required unless the undisclosed relationship is "trivial."[7]

The prophylactic rule of *Commonwealth Coatings* has been unequivocally endorsed by federal appellate courts, state supreme courts, and scholars. *See, e.g.*, *Middlesex Mutual Ins. Co.* v. *Levine*, 675 F.2d 1197, 1204 (11th Cir. 1982) (per curiam); *Sanko S.S. Co., Ltd.* v. *Cook Industries, Inc.*, 495 F.2d 1260, 1263-64 (2d Cir. 1973); *Barcon Associates* v. *Tri-County Asphalt Corp.*, 430 A.2d 214, 217 (N.J. 1981); *Richco Structures* v. *Parkside Village, Inc.*, 263 N.W.2d 204, 212 (Wis. 1978); *J.P. Stevens* v. *Rytex Corp.*,

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[7] "[A]rbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is *trivial*." 393 U.S. at 150 (White, J., concurring) (emphasis added).

312 N.E.2d 466, 468 (N.Y. 1974); G. Goldberg, *A Lawyer's Guide to Commercial Arbitration* 38 (1983).[8]

The district court applied the rule of *Commonwealth Coatings* carefully. It found that there was a relationship between Clifford and Merit which was "not trivial, insignificant or insubstantial" and that Clifford "not only did not disclose, but did everything he could not to disclose, even to the point of deception" (Dist. Ct. Opn., App. at 31-32). The district court held that vacatur was justified under *Commonwealth Coatings* because the record "disclosed a flaw, manifested from the beginning, characterized by deceit and fundamentally adverse to the notion of a fair and impartial proceeding" (Dist. Ct. Opn., App. at 30-31).

The Court of Appeals reversed the district court in an opinion that radically departs from the holding and rationale of *Commonwealth Coatings* and its progeny. Believing that *Commonwealth Coatings* "provides little guidance because of the inability of a majority of the Justices to agree on anything but the result" (7th Cir. Opn.,

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[8] Even in cases where vacatur is not granted, the continued viability of the rule in *Commonwealth Coatings* has never been doubted. *See, e.g., Andros Compania Maritima* v. *Marc Rich & Co.*, 579 F.2d 691, 699 (2d Cir. 1978) ("[O]ne common feature of both the plurality and concurring opinions in *Commonwealth Coatings* is clear. Disclosure by arbitrators should be encouraged; failure to make appropriate disclosure will justify setting aside an award."). Those cases apply the test enunciated by Justice White (*see* fn. 7, *supra*) and uphold arbitration awards when the district court has found either that the undisclosed relationship is trivial, *e.g., United States Wrestling Federation* v. *Wrestling Division of AAU*, 605 F.2d 313, 321 (7th Cir. 1979), or that the non-trivial relationship has in fact been disclosed, *e.g., International Produce, Inc.* v. *A/S Rosshavet*, 638 F.2d 548, 552 (2d Cir.), *cert. denied*, 451 U.S. 1017 (1981).

App. at 13), the Court of Appeals supplanted this Court's rule with a much different one of its own fashioning:

> [T]he test . . . is not whether the relationship was trivial; it is whether, having due regard for the different expectations regarding impartiality that the parties bring to arbitration than to litigation, the relationship between Clifford and Stern was so intimate—personally, socially, professionally, or financially—as to cast serious doubt on Clifford's impartiality. [7th Cir. Opn., App. at 10.]

"If circumstances are such that a man of average probity might reasonably be suspected of partiality," the court continued, "maybe the language of Section 10(b) can be stretched to require disqualification. But the circumstances must be powerfully suggestive of bias, and are not here." *Id.* at 12. The Court of Appeals' test seriously misstates the law.

B. THE COURT OF APPEALS DECISION IGNORES THE IMPORTANCE OF INITIAL DISCLOSURE IN THE ARBITRATION PROCESS.

The Court of Appeals erroneously treated this case "as if it had to be decided on the basis of first principles" (7th Cir. Opn., App. at 13). Two questions are relevant to this case: first, what kind of relationship must be disclosed by a neutral arbitrator; and, second, what happens if that kind of relationship is not disclosed? This Court answered those questions in *Commonwealth Coatings* fifteen years ago: an arbitrator must disclose any nontrivial relationship with a party, and failure to do so requires vacatur of the award. Thus, the balancing and weighing engaged in by the Court of Appeals had already been done by this Court. The balance had been struck in favor of disclosure as the way to protect the impartiality,

integrity, and fairness of arbitration. *Accord, Rogers* v. *Schering Corp.*, 165 F.Supp. 295, 301 (D.N.J. 1958), *aff'd*, 262 F.2d 180 (3d Cir. 1959).

The Court of Appeals, however, ignored the importance of disclosure and focused instead on the entirely separate issue of disqualification. The Court of Appeals held that vacatur was unnecessary here because "we doubt that the AAA would have disqualified Clifford—or that Leatherby would have wanted it to" (7th Cir. Opn., App. at 11).[9] The Court of Appeals' emphasis on disqualification misses the point because, as one commentator on arbitration has said, "the disqualifying nature of the relationship is not so significant as the failure adequately to disclose the relationship so that the parties and the AAA could determine whether it was disqualifying." G. Goldberg, *A Lawyer's Guide to Commercial Arbitration* 38 (1983). *Accord, Richco, supra*, 263 N.W.2d at 211.

Disclosure and disqualification are not equivalent terms. More must be disclosed by arbitrators than relationships that are "so intimate . . . as to cast serious doubt on [their] impartiality" or that are "powerfully suggestive of bias" (7th Cir. Opn., App. at 10, 12). *Any* non-trivial relationship with a party must be disclosed so that the other party may make an informed decision about whether to accept the arbitrator (wholly apart from whether he could be disqualified) or to challenge him. The concurring opinion of Justice White in *Commonwealth Coatings* makes precisely this point:

> [I]t is far better that the relationship be disclosed at the outset, when the parties are free to reject the arbitrator or accept him with knowledge of the relation-

[9] There is no evidence in the record to support the court's extraordinary speculation about the AAA's likely decision, and indeed, the record directly contradicts the court's conjecture about LIC's desires (Casey: HT 480-81).

> ship and continuing faith in his objectivity, than to have the relationship come to light after the arbitration, when a suspicious or disgruntled party can seize on it as a pretext for invalidating the award. [393 U.S. at 151.]

Yet this vital aspect of *Commonwealth Coatings*—and arbitration generally—was wholly ignored by the Court of Appeals.

The Court of Appeals has based its approach to this case on the premise that arbitration by its nature requires a "trade-off between impartiality and expertise" (7th Cir. Opn., App. at 8). If, by this language, the Court of Appeals means that parties give up impartiality when they choose arbitration as a process, the court is wrong. As Justice Black expressly held with respect to Section 10 of the United States Arbitration Act, "[t]hese provisions show a desire of Congress to provide not merely for *any* arbitration but for an impartial one." *Commonwealth Coatings*, 393 U.S. at 147 (emphasis in original). Disclosure protects that impartiality.

If, on the other hand, the court means that parties make deliberate choices about impartiality and expertise, the court is correct only with respect to the choices made at the time particular arbitrators are chosen. A party *may* choose a more experienced arbitrator with the flaw of a prior relationship with the opposing party over a less expert arbitrator, but such a "trade-off" must be *informed*, with both parties acting on the same information. As the Wisconsin Supreme Court has explained, the rule of full disclosure which is required by *Commonwealth Coatings* "permits the fully informed parties to balance the need for impartial arbitrators and the need for experienced, knowledgeable arbitrators when they select the arbitration panel." *Richco, supra*, 263 N.W.2d at 211-12. The district court expressly premised its decision on this im-

portant concept, stating "the essential question is whether or not [LIC] was entitled to have knowledge of the relationship so that it could make its own determination as to the likely impact of that relationship and its effect on important credibility determinations" (Dist. Ct. Opn., App. at 36; *cf.* App. at 28).

If an arbitrator fails to disclose non-trivial relationships, there can be no meaningful "trade-off." The Court of Appeals decision has disregarded the importance of initial disclosure and must therefore be reversed.

C. THE COURT OF APPEALS DECISION IGNORES THAT THE PARTIES TO THIS ARBITRATION BARGAINED FOR THE APPLICATION OF THE AAA'S DISCLOSURE RULES.

The district court held that Clifford "had a duty to disclose" under the AAA rules and that he breached that duty (Dist. Ct. Opn., App. at 22, 31). The Court of Appeals took the position that it is irrelevant whether or not Clifford violated the AAA's rules because they "do not have the force of law" and because "[i]f Clifford violated current ethical norms . . . , his was at worst a technical violation that does not justify setting aside [the] award" (7th Cir. Opn., App. at 11, 13). Such an attitude toward AAA standards is inconsistent with *Commonwealth Coatings*, which itself looked to the AAA's rules for guidance, 393 U.S. at 149, and with other cases.[10] Moreover, while the Court of Appeals emphasized the con-

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[10] For example, arbitrators in the Seventh Circuit have been warned to " 'bend over backward' to observe the [AAA's] rules and canons designed to insure both the reality and the appearance of neutrality." *United States Wrestling Federation* v. *Wrestling Division of AAU*, 605 F.2d 313, 322 (7th Cir. 1979) (Swygert, J., concurring).

tractual nature of arbitration (7th Cir. Opn., App. at 7), it gave no consideration to the fact that, by the terms of the reinsurance agreement, the parties bargained for and justifiably expected an arbitration conducted under the AAA rules. Clifford's violation of Section 18 of those rules breached that agreement. Accordingly, a new arbitration must be conducted in compliance with the terms of that agreement.

In the reinsurance agreement, Merit and LIC specified that "any controversy . . . shall be settled by arbitration *in accordance with the Rules of the American Arbitration Association*" (LX17, emphasis added). Under Section 18 of the AAA rules, a neutral arbitrator must disclose "any past or present relationship with the parties" (LX19). The AAA Notice of Appointment form makes clear that this rule requires the disclosure of *any* relationship whether "direct or indirect, whether financial, professional, social or other kind" and that "[a]ny doubt should be resolved in favor of disclosure" (LX2A). Not only did LIC contract for the AAA's disclosure requirements, it participated in the arbitration with the expectation that those rules would be followed. As LIC's arbitration counsel explained, during the selection process he "felt entitled to rely on the [rules] of the arbitration association, which required that an arbitrator disclose any relationship with a party or any attorney for the party" and would not have accepted Clifford had the relationship with Stern been disclosed (Casey: HT 492).

Because of the importance of the contractual nature of arbitration, courts have recognized that an arbitration award "will not be enforced if the arbitrator was not chosen in conformance with the agreement of the parties to arbitrate. . . ." *Tamari* v. *Conrad*, 552 F.2d 778, 781 (7th Cir. 1977). *See also Foodhandlers Local 425* v.

Pluss Poultry, Inc., 260 F.2d 835, 837 (8th Cir. 1958); *Local 227, Int'l Hod Carriers* v. *Sullivan*, 221 F.Supp. 696, 700-01 (E.D. Ill. 1963); *Carr* v. *American Insurance Co.*, 152 F.Supp. 700 (E.D. Tenn. 1957). The district court was therefore correct in its conclusion that the award cannot be allowed to stand, because of Clifford's breach of his duty to disclose under the AAA rules (Dist. Ct. Opn., App. at 22, 31).

D. THE COURT OF APPEALS DECISION WILL DISCOURAGE THE USE OF ARBITRATION AS AN ALTERNATIVE TO LITIGATION.

The Court of Appeals decision, if not reversed, will deal a serious blow to arbitration as an alternative to court litigation by undermining the main procedural safeguards of arbitration. When parties choose arbitration, they may be willing to forgo the full panoply of judicial procedures in order to save time and money, but they do not forgo basic fairness.

In court litigation, various devices to protect fairness are built into the system and guaranteed by an elaborate appellate review at the end of the process. By contrast, arbitration is subject to very limited appellate review. It provides its principal guarantee of fairness at the *beginning* of the process by allowing the parties to make an informed choice of arbitrators. *Commonwealth Coatings*, 393 U.S. at 149. Arbitration is thus distinguished from litigation by the sequence and timing of procedural protections, not—as the Court of Appeals believed—by their absence. It follows from the importance of informed choice that the burden of disclosure must be placed either on the arbitrators themselves or on the parties to an arbitration. If the burden is placed on the parties, they must devote substantial time and money to investigating each

potential arbitrator prior to making a selection. If the burden is placed on the arbitrators, there is no real burden at all, for they need only disclose what they already know: the existence of non-trivial relationships with parties to the arbitration proceedings.

Until the Court of Appeals decision in this case, there had been a broad consensus that, "for the arbitration process to work successfully, the onus must be placed on the arbitrator to reveal potential bias." *Middlesex, supra*, 675 F.2d at 1204. By refusing to enforce the AAA's disclosure requirements, the Court of Appeals "attempts to shift to the parties to the arbitration the burden of determining and disclosing bias or the reasonable appearance thereof," *Middlesex*, 675 F.2d at 1204. It thus rejects the approach urged by Justice White in *Commonwealth Coatings* (*see* text at 11, 14-15, *supra*) and followed, most recently, by the Eleventh Circuit in *Middlesex, supra*. By undermining the faith of parties in the fairness and integrity of the process and by increasing the burden on parties to investigate potential arbitrators, the Court of Appeals decision will discourage arbitration.

Nor will its decision even produce the results the Court of Appeals purported to desire. The court expressed a concern over "increas[ing] the cost and undermin[ing] the finality of arbitration" (7th Cir. Opn., App. at 17). Contrary to the belief of the Court of Appeals, it is the approach of this Court in *Commonwealth Coatings* and of the district court here that will keep down costs and reduce appeals. When an arbitrator makes full disclosure and is accepted by both parties, no future claim of partiality based on nondisclosure can lie under Section 10(b). Furthermore, as Justice White recognized in *Commonwealth Coatings*, "[i]f arbitrators err on the side of disclosure, as they should, it will not be difficult for courts to identify those undisclosed relationships which are too insubstantial to warrant vacating an award." 393 U.S. at 152.

By refusing to enforce the arbitrator's duty to disclose, the Court of Appeals endorsed a laissez-faire policy that compels every party to become a detective before arbitration begins. This shifting of the burden will make arbitration an expensive and time-consuming undertaking and will, in turn, discourage the use of arbitration as an alternative to litigation. The Court of Appeals' approach will drive many disputes back into already overcrowded courtrooms, thus disrupting both arbitration and litigation.

II. THE COURT OF APPEALS EXCEEDED THE BOUNDS OF PROPER JUDICIAL REVIEW.

A. FED. R. CIV. P. 60(b)(6) REQUIRES NO SHOWING THAT RERUNNING THE ARBITRATION BEFORE A DIFFERENT PANEL IS LIKELY TO CHANGE THE OUTCOME.

The Court of Appeals compounded its erroneous application of *Commonwealth Coatings* by reading into Rule 60(b)(6) a result-oriented test that is simply not there. Without citation of any authority, the Court of Appeals asserted that, in order to "make out a case for relief from judgment under Rule 60(b)(6) [LIC] had to show . . . that the violation [of the arbitrator's duty of disclosure] created a substantial danger of an unjust result" (7th Cir. Opn., App. at 16). The Court of Appeals then held that LIC had not made out a case for relief, because "rerunning the arbitration before a different panel is unlikely to change the outcome" (*id.*).[11]

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[11] This conclusion amounted to appellate court "fact-finding" and is sheer speculation. The panel made no independent evaluation of the arbitration record. The only basis cited (7th Cir. Opn., App. at 16) is an affidavit from one of the other arbitrators that was never offered into evidence during the hearing but was attached to Merit's later motion for reconsideration. The affiant was never

(footnote continued)

There is nothing in the case law construing Rule 60(b)(6) or in the language of the rule itself to support the Court of Appeals' notion that a Rule 60(b)(6) movant must show that he is likely to prevail on the merits before his motion can be granted. Traditionally, Rule 60(b)(6) relief is appropriate where there are extraordinary circumstances, *Klapprott* v. *United States*, 335 U.S. 601, 614-15 (1948), or unforeseen contingencies, *United States* v. *McDonald*, 86 F.R.D. 204, 208 (N.D.Ill. 1980); 7 *Moore's Federal Practice* ¶ 60.27[2] at 274 (1983). Significant discretion is vested in the district court in applying Rule 60(b)(6). *Fuhrman* v. *Livaditis*, 611 F.2d 203, 204 (7th Cir. 1979); *Matter of Emergency Beacon Corp.*, 666 F.2d 754, 760 (2d Cir. 1981). Accordingly, the only possible basis for the Court of Appeals' outcome test would have to be a finding that the district court abused its discretion by granting relief under Rule 60(b)(6) without proof that a different outcome in the arbitration is likely. The Court of Appeals did not find any abuse of discretion, nor could it have done so.

In order to understand why an outcome test is inappropriate here, it is essential to examine the context in which the district court's discretion was exercised. The Court of Appeals failed to recognize that the district court simultaneously made two different decisions: one substantive and one procedural. The district court's substantive decision was to vacate the arbitration award under Section 10(b) of the Arbitration Act and is tested solely by refer-

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(footnote continued)

called as a witness by Merit at the hearing and thus could not have been cross-examined by LIC.

While the issue is irrelevant under *Commonwealth Coatings* and Rule 60(b)(6), as explained below, LIC wishes to emphasize its belief that rerunning the arbitration before a different panel—one that does not include an arbitrator tained with "evident partiality"—*will* result in an entirely different outcome.

ence to *Commonwealth Coatings*. The procedural decision —which logically preceded the substantive—was to set aside its judgment in order to consider LIC's claim that Section 10(b) of the Arbitration Act had been violated. The effect of this decision under Rule 60(b)(6) was simply to allow LIC to present this claim *as if* it had been raised during the confirmation proceedings and before the judgment. This procedural decision is tested by the abuse of discretion standard.

In making its decision under Rule 60(b)(6), the district court was called upon to balance the need for fairness against the need for finality. *See Good Luck Nursing Home, Inc.* v. *Harris*, 636 F. 2d 572, 577 (D.C. Cir. 1980). The proper focus for the finality side of this balancing was not, as the Court of Appeals believed, the potential burden on the parties of a re-arbitration but was merely the reopening of the confirmation proceedings. This reopening did not entail any duplication of judicial effort, re-trial by the parties, or re-examination of issues previously considered. Rather, a new issue, going to the integrity of the arbitration process, was presented and considered. Thus, there was no meaningful burden associated with reopening the confirmation proceedings that could outweigh the compelling nature of LIC's claim under *Commonwealth Coatings*. Under these circumstances, there was no need for the district court to consider an outcome test.[12]

In support of its Rule 60(b)(6) motion, LIC showed—and the district court found—that it had no previous no-

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[12] Even if Rule 60(b)(6) *were* result-oriented, the Court of Appeals focused on the wrong "result." The relevant "result" for Rule 60(b)(6) purposes is a different *judgment* by the district court, not a different arbitration award. Here, it was obvious that granting LIC's motion was "likely to change the outcome" of the judgment, for the district court contemporaneously reached the merits of LIC's *Commonwealth Coatings* argument and did "change the outcome."

tice of, and no duty to discover, the Clifford-Stern relationship; that it had not learned of the relationship until April of 1982; and that it had brought its motion promptly thereafter (Dist. Ct. Opn., App. at 24). The discovery of the Clifford-Stern relationship plainly constituted a "reason justifying relief from the operation of the [confirmation] judgment," and the bringing of it to the court's attention within six months after the judgment was entered was plainly "within a reasonable time." That is all that Rule 60(b)(6) requires.

In *Commonwealth Coatings*, this Court decisively rejected the need to show the likelihood of a different result, for there the award was vacated even though it was unanimous and even though the arbitrator's conduct had been "entirely fair and impartial" during the arbitration. 393 U.S. at 151 fn., 152. It cannot therefore be disputed that, had LIC raised its claim under *Commonwealth Coatings* prior to the judgment confirming the award, LIC would not have had to satisfy the Court of Appeals' outcome test. The Court of Appeals should not be permitted to misread Rule 60(b)(6) and to engraft the alien concept of result-orientation onto the prophylactic rule of *Commonwealth Coatings*.

B. THE COURT OF APPEALS IGNORED FED. R. CIV. P. 52(a).

In reversing the district court's decision, the Court of Appeals ignored the district court's fact findings, without holding or even suggesting that they were "clearly erroneous." Rather it substituted its own interpretation of the evidence (7th Cir. Opn., App. at 4). This approach is impermissible under Rule 52(a), which "recognizes and rests upon the unique opportunity afforded the trial court to evaluate the credibility of witnesses and to weigh the evidence." *Inwood Laboratories, Inc.* v. *Ives Laboratories, Inc.*, 456 U.S. 844, 855 (1982).

Based on the record, the district court found that the Clifford-Stern relationship "was not an unimportant one, and it did not diminish by the passing of time" (Dist. Ct. Opn., App. at 38). The district court further found that, during the evidentiary hearing, Clifford "made an intentional effort to minimize his relationship with Mr. Stern" (Dist. Ct. Opn., App. at 20) and that Clifford was "untruthful" when he testified as to the reasons for failing to disclose his prior employment at Cosmopolitan Insurance Company on the two forms he filed with the AAA (Dist. Ct. Opn., App. at 20). The district court concluded that Clifford's failure to disclose his relationship with Stern, when "couple[d] . . . with his own conduct on [the] witness stand and his own conduct in connection with the submission of information to the [AAA], leads to the conclusion . . . that there was an *important* fact that was not disclosed—and intentionally so" (Dist. Ct. Opn., App. at 38, emphasis added).

The Court of Appeals construed away the district court's findings about Clifford's credibility, claiming to put them "in context" (7th Cir. Opn., App. at 4), and minimized the significance of the Clifford-Stern relationship ("Maybe it was trivial," 7th Cir. Opn., App. at 10). Indeed, the Court of Appeals relied on maxims instead of facts (*compare* 7th Cir. Opn., App. at 11 ["Time cools emotions, whether of gratitude or resentment"] *with* Dist. Ct. Opn., App. at 28-30, 35-36) and on assertions that are either speculative or in total disregard of the record (*see, e.g.*, fn. 9, *supra*). The strictures of Rule 52(a) cannot be avoided by pretending that the district court did not mean what it plainly said. The error committed by the Court of Appeals is precisely the one addressed by this Court in *Inwood Laboratories:*

> An appellate court cannot substitute its interpretation of the evidence for that of the trial court simply because the reviewing court "might give the facts another

> construction, resolve the ambiguities differently, and find a more [innocent] cast to actions which the District Court apparently deemed [sinister]." [456 U.S. at 857-58.]

Such error calls for an exercise of this Court's power of supervision.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Seventh Circuit.

DATED: October 19, 1983

Respectfully submitted,

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APPENDIX

APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

No. 82-2885

MERIT INSURANCE COMPANY,

Plaintiff-Appellant,

v.

LEATHERBY INSURANCE COMPANY a/k/a WESTERN EMPLOYERS INSURANCE COMPANY,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 80 C 6758—Charles P. Kocoras, *Judge.*

ARGUED MAY 31, 1983—DECIDED JULY 12, 1983

Before CUMMINGS, *Chief Judge,* POSNER, *Circuit Judge,* and FAIRCHILD, *Senior Circuit Judge.*

POSNER, *Circuit Judge.* This appeal from an order under Rule 60(b) of the Federal Rules of Civil Procedure setting aside an arbitration award requires us to decide whether the failure of one of the arbitrators to disclose a prior business relationship with a principal of one of the parties to the arbitration justified the district court in

using its powers under Rule 60(b) and the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, to set aside the award.

In 1972 Merit Insurance Company made a contract with Leatherby Insurance Company to reinsure claims under certain insurance policies that Leatherby had issued. Merit later sued Leatherby in federal district court for fraud in inducing the contract. Jurisdiction was based on diversity of citizenship. Leatherby moved the court for an order under 9 U.S.C. § 4 directing the parties to arbitrate their dispute in accordance with the arbitration clause in the contract, and in 1977 the district court entered such an order. See *Merit Ins. Co.* v. *Leatherby Ins. Co.*, 581 F.2d 137, 139 (7th Cir. 1978), and for collateral litigation *Merit Ins. Co.* v. *Colao*, 603 F.2d 654 (7th Cir. 1979).

The arbitration was conducted under the auspices of the American Arbitration Association. Each party appointed one arbitrator and together the parties appointed from a list formulated by the AAA the third or "neutral" arbitrator, a Chicago lawyer named Jack Clifford. At the first meeting of the arbitration panel the panel agreed that the other two arbitrators would also be neutrals, rather than representatives of the parties that had appointed them.

After an arbitration that lasted three years and produced a hearing transcript of 16,000 pages, the panel on December 1, 1980, unanimously awarded Merit $10,675,000 on its claim. Merit petitioned the district court to confirm the award under 9 U.S.C. § 9. Leatherby opposed confirmation in part on the ground that the arbitrators had been biased, as indicated by certain evidentiary rulings in Merit's favor and by a comment the arbitrator appointed by Merit had made in the course of the proceedings. No charge of bias was leveled against Clifford specifically.

The district judge rejected all of Leatherby's arguments and on November 19, 1981, confirmed the award. A month later he rejected Leatherby's first motion under Rule 60(b) to set it aside. Leatherby appealed to this court from both the order confirming the award and the order denying the Rule 60(b) motion. On May 12, 1982, while the appeal was pending, Leatherby filed a second Rule 60(b) motion, this one based on Leatherby's alleged discovery the previous month that Clifford had once worked under Merit's president and principal stockholder, Jerome Stern, at Cosmopolitan Insurance Company. The appeal was dismissed on Leatherby's motion, and an evidentiary hearing on its new charge of bias was held in the district court at the end of August. On November 4, 1982, in an oral opinion, the court granted Leatherby's Rule 60(b) motion and set aside the arbitration award, and Merit has appealed under 28 U.S.C. § 1291. See *University Life Ins. Co. of America* v. *Unimarc Ltd.*, 699 F.2d 846, 848 (7th Cir. 1983).

The hearing in the district court brought out the following facts. The chairman of the board of Cosmopolitan had hired Clifford late in 1960 to be head of the claims department. At the same time Stern had been promoted to executive vice-president of the company. As the vice-president in charge of the claims department Clifford reported to Stern. This relationship lasted till the beginning of 1963 when Stern left Cosmopolitan to enter private practice. Clifford left Cosmopolitan shortly afterward. Clifford and Stern both testified that they had had little professional contact while at Cosmopolitan and no social contacts then or since. Clifford had been promised substantial autonomy by the chairman of the board when he took over the claims department, and Stern—who had no background in claims evaluation and was preoccupied

with corporate acquisitions and other matters unrelated to Clifford's responsibilities—gave Clifford a loose rein. Their principal contact came in meetings held at intervals of several months between Stern and the department heads who reported to him. They also had occasional brief discussions over specific claims; once Clifford was asked to review the claims reserves of an insurance company that Cosmopolitan was thinking of buying; and, on orders from above, Stern once required all of his subordinates, including Clifford, to take lie-detector tests. After Clifford and Stern entered private practice they spoke to each other on the phone on one or two occasions but these contacts were of no significance, and until the arbitration the two men had not met face to face since 1963. Rotheiser, a vice-president of Merit, was also employed at Cosmopolitan during Clifford's tenure, but he was the head of a separate department and according to both his testimony and Clifford's they had no dealings with one another.

The foregoing account is drawn in large part from the testimony of Clifford himself, of whom the district judge stated, "I do not find Mr. Clifford to be a credible witness." But read in context this statement principally refers not to Clifford's testimony about his time at Cosmopolitan—testimony corroborated by Stern and Rotheiser, whom the district judge did not find to be incredible and who were not contradicted by any other witness—but to Clifford's explanation of why he omitted to mention his affiliation with Cosmopolitan either when he filled out the forms that the American Arbitration Association requires from its prospective arbitrators or when he first saw Stern at the arbitration hearing. In 1975 the AAA had sent Clifford a "panel data sheet" which contained a space headed, "My prior occupational affiliations have

been . . . ." All that Clifford listed in this space (having listed private practice as his current occupation) was his job as claims manager for Firemen's Fund American Insurance Companies from 1949 to 1960. Clifford testified that he had not mentioned Cosmopolitan in part because he was not interested in doing the kind of arbitration for which his experience there would have been relevant. The judge disbelieved this because it was the same kind of work Clifford had done at Firemen's Fund. (The judge made no comment on Clifford's other, and more plausible, explanation for not mentioning his work for Cosmopolitan: it was not a useful reference. Since the company had been liquidated, getting an evaluation of Clifford's work for the company would have been difficult.) But the judge could not have believed that the purpose of the omission was to prevent Clifford from being disqualified as an arbitrator, for the Merit-Leatherby arbitration was still two years in the future when Clifford mailed back the form. The judge conjectured, rather, that Clifford had been embarrassed to broadcast his relationship with Cosmopolitan, because after he had left it the company had gone broke, which resulted, in the district judge's words, in "an explosion in the industry." But when Clifford filled out another panel data sheet at the AAA's request three years later, he again omitted any reference to his work at Cosmopolitan; and when the arbitration began and Clifford recognized Stern and realized that the president of Merit and the former executive vice-president of Cosmopolitan were one and the same, he had said nothing.

Leatherby argues that by failing at each of these junctures to disclose his former relationship with Stern, Clifford violated the ethical norms applicable to arbitrators, and that the only effective sanction for such a violation is to set aside the arbitration award. It also argues that

Clifford did more than just fail to disclose his former relationship with Stern, that he tried to put Leatherby off the scent by calling Stern "Mr. Stern" rather than calling him by his first name; but there is no evidence that Clifford was doing anything other than maintaining the decorum of the arbitration proceeding.

The panel data sheet that the American Arbitration Association requires prospective arbitrators to fill out does not indicate that the information sought is for the purpose of determining whether grounds for disqualification exist, so no significance can be attached to Clifford's initial omission of his job history with Cosmopolitan. But section 18 of the AAA's Commercial Arbitration Rules requires the neutral arbitrator to "disclose to the AAA any circumstances likely to affect his impartiality, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their counsel." And Canon IIA of the Code of Ethics for Arbitrators in Commercial Disputes (jointly adopted by the American Arbitration Association and the American Bar Association) requires arbitrators to disclose "any existing or past financial, business, professional, family or social relationships which are likely to affect impartiality or which might reasonably create an appearance of partiality or bias." The requirement of disclosure is a continuing one, so the fact that Clifford's failure to disclose his relationship with Cosmopolitan in his first panel data sheet was innocent could not excuse his later failure to disclose the relationship when he accepted appointment as an arbitrator in the Merit-Leatherby dispute and when he recognized Stern on the first day of the arbitration hearing.

Notwithstanding the broad language of section 18, no one supposes that either the Commercial Arbitration Rules or the Code of Ethics for Arbitrators requires disclosure of every former social or financial relationship with a party or a party's principals. The Code states that its provisions relating to disclosure "are intended to be applied realistically so that the burden of detailed disclosure does not become so great that it is impractical for persons in the business world to be arbitrators, thereby depriving the parties of the services of those who might be best informed and qualified to decide particular types of cases." Quoting from Justice White's concurring opinion in *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145, 150-52 (1968)—of which more anon—the Code states that although "arbitrators 'should err on the side of disclosure' . . . , it must be recognized that 'an arbitrator's business relationships may be diverse indeed, involving more or less remote commercial connections with great numbers of people' [so that] an arbitrator 'cannot be expected to provide the parties with his complete and unexpurgated business biography,' . . . [or] to disclose interests or relationships which are merely 'trivial.'"

The ethical obligations of arbitrators can be understood only by reference to the fundamental differences between adjudication by arbitrators and adjudication by judges and jurors. No one is forced to arbitrate a commercial dispute unless he has consented by contract to arbitrate. The voluntary nature of commercial arbitration is an important safeguard for the parties that is missing in the case of the courts. See *Corey* v. *New York Stock Exchange*, 691 F.2d 1205, 1210 (6th Cir. 1982). Courts are coercive, not voluntary, agencies, and the American people's traditional fear of government oppression has resulted in a judicial system in which impartiality is prized above

expertise. Thus, people who arbitrate do so because they prefer a tribunal knowledgeable about the subject matter of their dispute to a generalist court with its austere impartiality but limited knowledge of subject matter. "The professional competence of the arbitrator is attractive to the businessman because a commercial dispute arises out of an environment that usually possesses its own folkways, mores, and technology. Most businessmen interviewed contended that commercial disputes should be considered within the framework of such an environment. No matter how determinedly judge and lawyer work to acquire an understanding of a given business or industry, they cannot hope to approximate the practical wisdom distilled from 30 or 40 years of experience." American Management Ass'n, Resolving Business Disputes 51 (1965).

There is a tradeoff between impartiality and expertise. The expert adjudicator is more likely than a judge or juror not only to be precommited to a particular substantive position but to know or have heard of the parties (or if the parties are organizations, their key people). "Expertise in an industry is accompanied by exposure, in ways large and small, to those engaged in it . . . ." *Andros Compania Maritima, S.A.* v. *Marc Rich & Co.*, 579 F.2d 691, 701 (2d Cir. 1978). The different weighting of impartiality and expertise in arbitration compared to adjudication is dramatically illustrated by the practice whereby each party appoints one of the arbitrators to be his representative rather than a genuine umpire. See Note, *The Use of Tripartite Boards in Labor, Commercial, and International Arbitration*, 68 Harv. L. Rev. 293 (1954). No one would dream of having a judicial panel composed of one part-time judge and two representatives of the parties, but that is the standard arbitration panel, the panel Leatherby chose—presumably because it preferred a more

expert to a more impartial tribunal—when it wrote an arbitration clause into its reinsurance contract with Merit.

If Leatherby had wanted its dispute with Merit resolved by an Article III judge (to whom it had access under the diversity jurisdiction), it would not have inserted an arbitration clause in the contract, or having done so move for arbitration against Merit's wishes. Leatherby wanted something different from judicial dispute resolution. It wanted dispute resolution by experts in the insurance industry, who were bound to have greater knowledge of the parties, based on previous professional experience, than an Article III judge, or a jury. The parties to an arbitration choose their method of dispute resolution, and can ask no more impartiality than inheres in the method they have chosen. cf. *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944) (L. Hand, J.).

It is no surprise, therefore, that the standards for disqualification in the Commercial Arbitration Rules and the Code of Ethics for Arbitrators are not so stringent as those in the federal statutes on judges, see, e.g., 28 U.S.C. § 455, or in Canons 2 and 3(C) of the Code of Judicial Conduct for United States Judges and the ABA's Code of Judicial Conduct. (In fact the arbitration rules and code do not contain any standards for disqualification as such, though such standards are implicit in the disclosure requirements of the AAA's Rules and the AAA-ABA Code.) We thus do not agree with Leatherby that the test for disqualification here is whether the former relationship between Stern and Clifford was "trivial" in relation to the subject matter of the arbitration. If it were trivial Clifford would not have had to disqualify himself even if he had been a judge. See, e.g., *Chitimacha Tribe of Louisiana* v. *Harry L. Laws Co.*, 690 F.2d 1157, 1166 (5th

Cir. 1982); *United States Fidelity & Guaranty Co.* v. *Lawrenson*, 334 F.2d 464, 466 (4th Cir. 1964); Interim Advisory Committee on Judicial Activities, Advisory Opinion No. 11 (Jan. 21, 1970), in Code of Judicial Conduct for United States Judges at p. II-26 ("It cannot be that [law] firms are precluded from practice before judges simply because members have judges for friends. Here again there may be special circumstances dictating disqualification, but a friendly relationship is not sufficient reason in itself").

Maybe it was trivial. *Chitimacha* held that a district judge did not have to disqualify himself from a case in which the defendant was a corporation that the judge had represented when he was in private practice, since the representation had terminated at least six years before. That was a professional relationship, like Clifford's with Stern—only a more recent one. But the test in this case is not whether the relationship was trivial; it is whether, having due regard for the different expectations regarding impartiality that parties bring to arbitration than to litigation, the relationship between Clifford and Stern was so intimate—personally, socially, professionally, or financially—as to cast serious doubt on Clifford's impartiality. Although Stern had been Clifford's supervisor for two years and was a key witness in an arbitration where the stakes to the party of which he was the president and principal shareholder were big, their relationship had ended 14 years before, Clifford had no possible financial stake in the outcome of the arbitration, and his relationship with Stern during their period together at Cosmopolitan had been distant and impersonal. The fact that they had never socialized, either while working for the same company or afterward (though both were practicing law in Chicago all this time), indicates a lack of intimacy. And when a former employee sits in judgment on

a former employer there is no presumption that he will be biased in favor of the former employer; he may well be prejudiced against him. The fact that Clifford passed his lie-detector test with flying colors might have made him grateful to Stern, or might have fanned the flames of outrage at having been subjected to such an indignity, or more likely made no difference at all because it happened so long ago. Time cools emotions, whether of gratitude or resentment.

Section 18 of the Commercial Arbitration Rules makes the AAA itself the final arbiter of disqualification once the arbitrator has been appointed, subject only (so far as relevant here) to the limited judicial review allowed by section 10 of the Arbitration Act, 9 U.S.C. § 10, after an arbitration award is made and judicial confirmation of it sought. On the basis of the facts reviewed above, considered in the light of the less stringent standards applicable to disqualification of arbitrators than to disqualification of judges, we doubt that the AAA would have disqualified Clifford—or that Leatherby would have wanted it to.

But even if the failure to disclose was a material violation of the ethical standards applicable to arbitration proceedings, it does not follow that the arbitration award may be nullified judicially. Although we have great respect for the Commercial Arbitration Rules and the Code of Ethics for Arbitrators, they are not the proper starting point for an inquiry into an award's validity under section 10 of the United States Arbitration Act and Rule 60(b) of the Federal Rules of Civil Procedure. The arbitration rules and code do not have the force of law. If Leatherby is to get the arbitration award set aside it must bring itself within the statute and the federal rule. The statute specifies limited grounds for setting aside an arbitration award. The only one relevant here is, "Where

there was evident partiality or corruption in the arbitrators, or either of them." 9 U.S.C. § 10(b). (Leatherby does not argue that the award can be set aside on any other ground in the statute, such as "misbehavior" of an arbitrator, in section 10(c).) This is strong language. It makes the grounds for setting aside an arbitrator's award because of bias narrower than the grounds for disqualification in the arbitration rules and code, not to mention the statutes and ethical codes pertaining to judges. Read literally, section 10(b) would require proof of actual bias ("evident partiality"). And not only the arbitrator appointed by Merit, as one might expect, but also the arbitrator appointed by Leatherby—a member of a distinguished Chicago law firm—gave a detailed affidavit denying absolutely and in detail that Clifford had ever evinced any partiality during the three years of the arbitration.

Of course actual bias might be present yet impossible to prove; Clifford might have given no indication of his vote yet have been irrevocably committed to Merit out of some obscure sense of gratitude toward, or exaggerated respect for, Stern. If circumstances are such that a man of average probity might reasonably be suspected of partiality, maybe the language of section 10(b) can be stretched to require disqualification. But the circumstances must be powerfully suggestive of bias, and are not here.

The American Arbitration Association is in competition not only with other private arbitration services but with the courts in providing—in the case of the private services, selling—an attractive form of dispute settlement. It may set its standards as high or as low as it thinks its customers want. The statute has a different purpose—to make arbitration effective by putting the coercive force of the federal courts behind arbitration decrees that affect interstate commerce or are otherwise of federal concern. See 9 U.S.C. § 1; S. Rep. No. 536, 68th

Cong., 1st Sess. 3 (1924). The statute does not provide a dispute settlement mechanism; it facilitates private dispute settlement. The standards for judicial intervention are therefore narrowly drawn to assure the basic integrity of the arbitration process without meddling in it. Section 10 is full of words like corruption and misbehavior and fraud. The standards it sets are minimum ones. The ethical concerns expressed by Leatherby are remote from the draftmen's concerns. The Senate Report, for example, refers approvingly to " 'arrangements for avoiding the delay and expense of litigation and referring a dispute to friends . . . .' " S. Rep. No. 536, *supra*, at 3. The fact that the AAA went beyond the statutory standards in drafting its own code of ethics does not lower the threshold for judicial intervention. If Clifford violated current ethical norms for commercial arbitrators, his was at worst a technical violation that does not justify setting aside an arbitration award on the statutory ground of evident partiality or corruption. Concern with professional reputation will provide some deterrent to such violations, especially where the arbitrator is a lawyer, as he was here.

We have discussed the issue of the award's validity as if it had to be decided on the basis of first principles—as it very largely does. Prior cases involve factual situations very different from the one here and do not yield general principles. The only Supreme Court decision, *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968), provides little guidance because of the inability of a majority of Justices to agree on anything but the result. Justice Black, joined by three other Justices, took a very hard line on the ethical standards of arbitrators. His opinion contains language suggesting that arbitrators are subject to the same ethical standards as judges, although this is dictum because the facts of the case required disqualification

even under a narrow reading of section 10(b): the "neutral" arbitrator was a regular supplier of one of the parties to the arbitration, and had even rendered services on projects involved in the arbitration. Justice White, concurring, purported to join Justice Black's opinion but actually took a quite different tack, the sense of which is captured in the passages we quoted earlier from the Code of Ethics for Arbitrators--which treats Justice White's opinion as a surer guide to the view of a majority of the Supreme Court than Justice Black's. Justice White stated, "The Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges," 393 U.S. at 150, and since his vote was essential to a majority, what he said the Court did not decide the Court did not decide, whatever Justice Black may had hoped. Our court, in *United States Wrestling Federation* v. *Wrestling Division of AAU, Inc.*, 605 F.2d 313, 319 (7th Cir. 1979), treated Justice White's opinion as authoritative.

Although it is difficult to extract from the cases more than a mood, the mood is one of reluctance to set aside arbitration awards for failure of the arbitrator to disclose a relationship with a party. See, e.g., *Andros Compania Maritima, S.A.* v. *Marc Rich & Co., supra,* 579 F.2d at 700. In *Andros,* the arbitration award was confirmed although the neutral arbitrator, Nelson, had not disclosed that he had in the recent past sat on 19 arbitration panels with the president of one of the firms involved in the arbitration and in 12 of these panels the president had been one of the arbitrators who had selected Nelson to be the neutral. Disqualification of the neutral arbitrator was also rejected in *International Produce, Inc.* v. *A/S Rosshavet,* 638 F.2d 548, 551 (2d Cir. 1981), even though, during the arbitration, he had been a witness in another case between the same law firms that were try-

ing the arbitration matter before him. In *Middlesex Mutual Ins. Co.* v. *Levine*, 675 F.2d 1197 (11th Cir. 1982) (per curiam), an arbitration award was set aside for "evident partiality," but there a company owned by the neutral arbitrator's family was entangled in a dispute with the parties to the litigation in which he personally had lost $85,000, and he also was under investigation for alleged unethical conduct involving those parties.

The suggestion in *Tamari* v. *Bache Halsey Stuart, Inc.*, 619 F.2d 1196 (7th Cir. 1980), that "appearance of bias" is a proper standard for disqualification of arbitrators is not inconsistent with anything in our present opinion; it just means that it is unnecessary to demonstrate—what is almost impossible to demonstrate—that the arbitrator has an actual bias. The standard is an objective one, but less exacting than the one governing judges.

Finally, it is significant that the issue of disqualification was raised here by a Rule 60(b) motion to set aside the award, filed some 18 months after the award had been issued by the arbitration panel (though only six months after it was confirmed by the district court). We asked Leatherby's counsel at oral argument whether he thought it would make a difference in this case if the Rule 60(b) motion had come 10 years after the award, with everything else in the case remaining the same. He said it would not. The framers of Rule 60(b) set a higher value on the social interest in the finality of litigation. A motion under Rule 60(b) seeks an extraordinary remedy, *DiVito* v. *Fidelity & Deposit Co. of Maryland*, 361 F.2d 936, 938 (7th Cir. 1966), especially where as in this case the motion is based on the catch-all provision of Rule 60(b), Rule 60(b)(6) ("any other reason justifying relief from the operation of the judgment"). *Ackermann* v. *United States*, 340 U.S. 192, 200 (1950); *Stradley* v. *Cortez*, 518 F.2d 488, 493 (3d Cir. 1975); *Naxon Telesign Corp.* v.

GTE Information Systems, Inc., 89 F.R.D. 333, 337 (N.D. Ill. 1980); 11 Wright & Miller, Federal Practice and Procedure § 2857, at p. 160 (1973). (Leatherby does not argue that Merit's failure to disclose Stern's former relationship with Clifford was fraud under Rule 60(b)(3).) To make out a case for relief from judgment under Rule 60(b)(6) Leatherby had to show not only that an arbitrator had violated the ethical and legal standards for arbitrators but that the violation created a substantial danger of an unjust result.

It failed to show this. Its counsel conceded at oral argument that his client would be bound to submit to a new arbitration proceeding if the award were set aside. But in the old proceeding Leatherby's own arbitrator voted against it. If we may believe that arbitrator's affidavit—and there is no reason not to—he did not regard this as a close case. According to the affidavit, both he and Merit's arbitrator pushed Merit's case harder than Clifford did. We need not decide whether Clifford was bending over backwards to avoid showing partiality toward Merit in view of his former relationship with Stern or whether, as the affidavits and his own testimony suggest, he is of a retiring disposition and had less experience in the subject matter of the arbitration than the other two arbitrators. It is enough to note that rerunning the arbitration before a different panel is unlikely to change the outcome.

Furthermore, as it is likely that if Leatherby had known about Clifford's former relationship with Stern it would not have cared, because it would not have been able to figure out any more than we can how that relationship would cut in terms of partiality toward or prejudice against Merit, we think Leatherby was required, and it failed, to support its Rule 60(b) motion with affidavits that its officers did no know of the relationship. It had to negate any

inference that it had implicitly consented to have Clifford as an arbitrator knowing all it now knows but saying nothing. We note in this regard the perfunctory investigation that Leatherby made into Clifford's background when the AAA first listed him as a possible arbitrator. Leatherby argues that it would have been burdensome to investigate all 26 names on the list and that it was entitled to trust any potential arbitrator to comply with the AAA's disclosure requirements. It points out that the cost of arbitration will be increased if parties, not being able to trust the disclosure requirements, must conduct elaborate background investigations. It is true that the disclosure requirements are intended in part to avoid the costs of background investigations. But this is a $10 million case. If Leatherby had been worried about putting its fate into the hands of someone who might be linked in the distant past to the adversary's principal, it would have done more than it did to find out about Clifford. That is did so little suggests that its fear of a prejudiced panel is a tactical response to having lost the arbitration.

We do not want to encourage the losing party to every arbitration to conduct a background investigation of each of the arbitrators in an effort to uncover evidence of a former relationship with the adversary. This would only increase the cost and undermine the finality of arbitration, contrary to the purpose of the United States Arbitration Act of making arbitration a swift, inexpensive, and effective substitute for judicial dispute resolution. This lawsuit is already eight years old. To uphold the district court's vacation of the arbitration award in the absence of evidence of actual or probable partiality or corruption would open a new and, we fear, an interminable chapter in the efforts of people who have chosen arbitration and been disappointed in their choice to get

the courts—to which they could have turned in the first instance for resolution of their disputes—to undo the results of their preferred method of dispute resolution.

The judgment of the district court setting aside his earlier judgment confirming the arbitration award in favor of Merit is reversed, and the case is remanded with directions to reinstate the previous judgment.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

MERIT INSURANCE COMPANY,	)	
	)	
Plaintiff,	)	
	)	
v.	)	80 C 6758
	)	
LEATHERBY INSURANCE COMPANY,	)	
	)	
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

had in the above-entitled cause before the Honorable CHARLES P. KOCORAS, one of the Judges of said court, in his courtroom in the United States Courthouse, Chicago, Illinois on September 10, 1982 at the hour of 10:00 a.m.

• • •

THE CLERK: 80 C 6758, Merit Insurance v. Leatherby. Ruling.

MR. RIEGER: Good morning, your Honor, Mitchell Rieger for Leatherby.

MR. HOLSTEIN: Robert Holstein for Merit Insurance.

THE COURT: Good morning.

I have reviewed my notes, I have looked at what I think are the relevant exhibits and these are my findings:

First, I think I need to address the credibility of Mr. Clifford, since I think that is an issue both with respect to his testimony in the hearing, and it touches his conduct during the time of the arbitration proceedings. I will be more specific about the latter as I go through my views of this case.

I do not find Mr. Clifford to be a credible witness, and I think he was untruthful when he testified as to the reasons he omitted the Cosmopolitan Insurance experience and affiliation with that company on the form—two forms —that he submitted to the American Arbitration Association.

First of all, I do not think that you can fairly read the letter requesting the completion of the form to limit the experiences to be put on that form to those areas in which Mr. Clifford was seeking to be an arbitrator. The form, itself, contained no such limitation; but past that it is absurd to think that he did not list the Cosmopolitan Insurance Company experience because he was not interested in doing that kind of litigation, when he listed on the very same form an experience with the Fireman's Fund—I think that was the name of the company—as a Claims Manager, the identical position and duty that he held with Cosmopolitan Insurance Company.

To offer that up as a reason for the omission is simply not worthy of belief.

I, also, in reviewing my notes and really listening to Mr. Clifford, found that in some instances Mr. Clifford made an intentional effort to minimize his relationship with Mr. Stern beyond what I believe the facts would support.

I find that Mr. Clifford started with Cosmopolitan Insurance Company around October 10th of 1960. Mr. Stern

became Executive Vice President of Cosmopolitan Insurance Company around November of 1960; and up until Mr. Stern left around February 28th of 1963, and during that time, I find Mr. Stern supervised the Claims Department, which was headed by Mr. Clifford, and Mr. Clifford reported to Mr. Stern.

Now, with respect to Leatherby Exhibit 2-A, the Notice of Appointment form, that form put Mr. Clifford on notice that it was important to disclose the prior relationships with the parties or their counsel. That form also said that the relationship with the parties included indirect as well as direct relationships. That form also said that any doubt should be resolved in favor of disclosure.

I will not read into the record the particular section of Exhibit 2-A that I am alluding to, that may well have been read once, but there is no question at all that any doubt should be resolved in favor of disclosure, a point which Justice White made very clear in his concurring opinion in the leading case on the subject. I will get to that later.

Now, on Leatherby Exhibit 3, the Panel Data Sheet, I do find that Mr. Clifford intentionally withheld the Cosmopolitan Insurance relationship.

I am not sure on that form why he did, but he did. It may be, as was suggested in a question, that he wanted to disassociate himself from that experience because of what happened to Cosmopolitan Insurance Company. I think the word was that it was an explosion in the industry, or certainly a coming apart of a company of that proportion for the first time; something perhaps others did not want to be connected with. I do not know if that is the reason, or if there are other reasons, but there is no question that that prior relationship was withheld and intentionally so.

The Panel Data Sheet Update is also significant. Now, on that form Mr. Clifford not only failed to disclose his prior relationship with Cosmopolitan, but he falsely stated a different relationship for the relevant time period. He omitted the Cosmopolitan tenure and misstated the year he was with the law firm and the name of that law firm during this relevant time.

Now, why is that significant? That form was submitted by Mr. Clifford during the pendency of the arbitration case. It does not take much to think that Mr. Clifford may have thought that by putting down the truth, and if somebody read that, it may be some reason why he could not continue to participate as an arbitrator. I find that Mr. Clifford had a duty to disclose, and he had notice of that duty or obligation to disclose. His Notice of Appointment contained that duty. The Manual for Commercial Arbitrators — Leatherby Exhibit 18, Page 5 — says that; and what else demonstrates his duty to disclose was his own testimony with respect to Mr. Stern.

At the time he got Exhibit 17, the Reinsurance and Assumption Agreement and the name of Mr. Jerome Stern on it, Mr. Clifford testified that when he first got that he thought it was the same Stern, but did not do anything until Stern testified; and at some point he went and read Section 18 and concluded from reading that, that it did not require disclosure, and he did not disclose it to anybody and did not inquire of anybody at the American Arbitration Association whether or not he should disclose it.

I find that Mr. Clifford had a duty to disclose his prior relationship with Mr. Stern and Mr. Rotheiser; and, particularly, with Mr. Stern.

Mr. Clifford would have you believe that the existence of the duty is purely a subjective consideration unrelated to reason and unrelated to the cautionary instruction that preceded him when the duty was ripe. That is simply not so. No person can sit back and say, "Well, in my own view I need not disclose it because my own view is that that relationship will not affect me. Therefore, I will not disclose it."

If that was the case, then there would not need to be any rules in the first instance.

Now, with respect to the subject matter of the possibility of getting this information from other sources, Best's would not have disclosed that prior relationship during the arbitration years, a time when at least theoretically is when counsel for Leatherby would have been looking at Best's. The exhibits which reflect Best's Recommended Insurance Attorneys for 1976 and 1977, and 1977 and 1978, and all later years do not show that Jack Clifford once was an officer of Cosmopolitan Insurance Company.

Martindale-Hubbell, those available during the arbitration years, would not have disclosed that; and there was not any reason, very frankly, why Leatherby should have and was required to make an exhaustive search of materials or records possibly available with respect to the years 1960 to 1963 in order to determine Mr. Clifford's prior affiliations. There was not any reason for them to jump back to that.

Now, I admit and recognize that the attorneys for Leatherby did not even check what the American Arbitration Association had on their cards, which was used for the purpose of informing parties what the background of potential arbitrators is. There was a check made, and whether that check—and given hindsight—was sufficient or not, I find of no moment in deciding the issues before

me. A check was made. Mr. Clifford was not blindly accepted. The significant point is that there was nothing to trigger in the minds of Leatherby or its counsel a need to look into the early 1960's about Clifford's relationship, and they did not do so.

The burden for that, as is abundant in the AAA materials, is on the arbitrator—particularly as the one manual says, at the first hearing when you see somebody, and at that point it is confirmed that you know that somebody; in fact, know him to the point that you worked with and under them for two years—to disclose that and that was not done.

I find that Leatherby and its attorneys and agents were unaware of Mr. Clifford's prior associations with Cosmopolitan Insurance and Jerome Stern and had no obligation or duty to act more diligently than they did.

Although I believe that due diligence in bringing this motion or in pursuing a prior investigation of Mr. Clifford is not required, there is no showing that due diligence is lacking here. The evidence in this record about Clifford's prior association is that information was first received by Leatherby or its attorneys about April of 1982, and not before, although I recognize that the source of that information is not disclosed by this record.

I also find no waiver by Leatherby of their right to the disclosure that I find should have been made by Mr. Clifford.

I agree with Mr. Rieger and believe that there was an utter insensitivity to disclosure by Mr. Clifford; and, indeed, a purposeful attempt to conceal a relevant prior relationship during the arbitration proceedings when a false and fraudulent Update Panel Data Sheet—Leatherby Exhibit 3-A—was submitted by Mr. Clifford.

Even though during the hearing Mr. Clifford made some attempt to put some distance between himself and Exhibit 3-A, because 3-A was not signed, and he had no recollection of the method of its preparation; and in the last analysis, his testimony was, "I am not responsible for 3-A," I do not credit that testimony. There is no doubt in my mind and I find that 3-A was the product of Mr. Clifford and he occasioned the preparation and submission of 3-A, and he was responsible and accountable for its presentation and submission.

Now, let us take the law that governs the outcome of this case; and, of course, the leading case, and that which provides the principal guidance, is Commonwealth Coatings Corporation vs. Continental Casualty Company, et al. I am sure you are all familiar with that case. Justice Black, in writing the plurality opinion of the Court, said that there is a simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias.

He said, and I am adding some of my own thoughts, that it is important to disclose, since the arbitrators decide the law as well as the facts—and I also submit to you that arbitrators clearly are not unlike judges; and because the scope of review is not great in this Court over arbitration awards, it is all the more reason why there should not be an impropriety that takes place during the arbitration case itself.

Justice Black said that arbitrators must avoid even the appearance of bias.

Justice White in his concurrence said:

> "Arbitrators are not automatically disqualified by a business relationship with the parties before them

if both parties are informed of the relationship in advance, or if they are unaware of the facts, but the relationship is trivial."

He said further that an atmosphere of frankness should be established at the outset.

Justice Fortas in his dissent said that in that case there was no suggestion of concealment as distinguished from innocent failure to volunteer information.

In the case in this circuit, which is the leading case guiding me here, the case of United States Wrestling Federation v. Wrestling Division of the AAU, in that case it involved an attorney you probably all know, Mr. Blair White of Sidley & Austin who was an arbitrator in that case, and the Court here said that Mr. White's relationship to the party—the party being the United States Wrestling Federation—was too remote, uncertain and speculative, and cited the Lucke test; Lucke being, as I recall, a State of Illinois case.

In the Wrestling case, Blair White was a partner at Sidley & Austin and some of his other partners were very closely affiliated with Northwestern. In fact, I think one of them was General Counsel and had offices there, as I recall the facts of that case, and Northwestern happened to be a member of the NCAA, along with 800-some other universities, and it was the NCAA that was, among other things, financing the arbitration case.

Now, you see the tenuous nature of the connection between Blair White and the United States Wrestling Federation. It is clearly not direct, and clearly extremely tenuous, uncertain and speculative because Blair White officed with people who had a close contact with Northwestern, which was a member of the NCAA, which was

financing one of the parties to this case. It was urged that Blair White should have disclosed that. It is not surprising that the result was what it was.

The Seventh Circuit in that case said that Mr. White's indirect connection with Northwestern did not present the appearance of impropriety with respect to the NCAA.

Judge Pell went on to say that failure to check the background of the arbitrators was not suggested to constitute a waiver.

Justice Swygert in his concurrence in that case said:

> "When an arbitrator's neutrality could be subject to any legitimate doubt, it would seem the wiser course to disclose the relationships with the interested parties rather than to brush the boundaries of the ethic expressed in Rule 18."

Now, there is another case that I have reviewed in my legal travels, the case of Tamari v. Bache Halsey Stewart. Now, that case is seemingly not on point factually, and I do not profess that it is, but first of all it is not an American Arbitration Association case, and what happened in that case is that a non-occurrence witness was hired by the firm employing one of the arbitrators who, at the point of the hiring of that non-occurrence witness, at that point he disclosed that and offered to withdraw, an offer which was accepted. Judge Tone in his opinion said —and this I find significant:

> "It is relevant to the appearance of the bias issue as well as to the actual bias issue that Fivian was not an occurrence witness but rather Bache's delegate to produce documents and answer questions about the firm's operating procedures."

In this case, Mr. Stern was the most important, if not only, occurrence witness on the question of liability, and his credibility was a not insignificant question.

Did Mr. Clifford, over the course of two-plus years, form an opinion about Mr. Stern, both as a person and as a witness, by virtue of his prior relationship with him?

More significantly, was Leatherby entitled to know the nature of that relationship and make its own decision about that?

Well, let us look at the relationship. It is clear that Mr. Clifford headed the Claim Department at Cosmopolitan Insurance Company. It is clear also that he attended at least 10 meetings of department heads that were held by Mr. Stern, and during these meetings Mr. Clifford reported the work of his department.

It is clear to me also that Mr. Clifford answered to him and reported on matters of great importance to Cosmopolitan Insurance Company, matters relating to alleged improprieties in handling claims.

The record is also clear that Mr. Stern ordered Mr. Clifford and those involved in claims matters to take polygraph examinations and that Mr. Stern had the responsibility, at least initially, of deciding whether or not Mr. Clifford was going to retain his job.

It is also clear in this record that Mr. Clifford was entrusted to make an evaluation of various documents of another insurance company by Mr. Stern and did so for the purpose of acquisition of that company by Cosmopolitan Insurance and ultimate merger, which was neither a routine nor insignificant undertaking.

Mr. Clifford and Mr. Stern officed about 75 feet apart for a period of approximately two years, although the record is clear that Mr. Stern was occupied with many activities other than Cosmopolitan Insurance Company during that time which had nothing to do with Mr. Clifford, and he was out of the office a lot. I recognize that, but I also recognize that they officed that close together; and when they were both in that office, they had to see each other and pass each other, aside from the corporate responsibilities one had to the other.

It is also clear that Mr. Clifford and Mr. Stern were shareholders in the same company during a common period of time.

This record also demonstrates that Mr. Clifford's law firm represented clients in cases in which Mr. Stern's law firm represented adverse clients; and although there is neither evidence nor any suggestion of impropriety in the handling of those cases by any member of either law firm, some of those cases took place prior to and during the course of the arbitration case.

The evidence does demonstrate that Mr. Clifford was not socially friendly with either Mr. Stern or Mr. Rotheiser, and apparently did not have business lunches with either of them.

Nonetheless, in my view this was clearly not a trivial or insubstantial relationship, and I find that it was not.

Mr. Rieger argues persuasively that Colonel Cage made a judgment call about Mr. Clifford, a judgment call Mr. Clifford necessarily had to make about Mr. Stern on more information. Colonel Cage had less information about Mr. Clifford than Mr. Clifford had about Mr. Stern.

And these formed judgments so important and strong as to be lasting, at least 15-years worth?

Colonel Cage was vigorous in his testimony as to Mr. Clifford's reputation and standing 19 years after his connection with Mr. Clifford. Would that be no less true when Mr. Clifford was asked to speak of Mr. Stern?

Was not Leatherby entitled to make that decision as to whether or not they thought that Clifford may have had some opinion and formed some belief in the credibility of Mr. Stern? Was not Leatherby entitled to make that decision? I think they were.

Do you know what? If the shoe was on the other foot, Merit had the same right.

Is not the very reason which Mr. Clifford said caused him to read Section 18—referred to as Rule 18, assuming that he read it—the very reason, and obviously so, that required disclosure? And what do you make of the affirmative effort on Exhibit 3-A during the arbitration to conceal evidence of that prior relationship?

I believe that the significance of that relationship and its possible effect was what motivated that misdeed on 3-A.

What this case presents in my view is the fundamental issue of what are minimum acceptable standards in the conduct of a proceeding, not dissimilar to that which this Court engages in with regularity, and the integrity of that proceeding.

This Court is not unmindful of the length of the arbitration proceedings, nor the work that went into it, nor the importance to both sides of the award which was made, and later confirmed by me, but none of that can stand in

the face of a record which disclosed a flaw, manifested from the beginning, characterized by deceit and fundamentally adverse to the notion of a fair and impartial proceeding.

As I said earlier, Justice White says an atmosphere of frankness should be established at the outset. Here, we have an atmosphere of non-disclosure.

In sum, I find that Mr. Clifford had a duty to disclose; I find Mr. Clifford breached that duty and not, as Justice Fortas in his dissent in the Commonwealth case found significant, an innocent failure to volunteer information. There was a failure to volunteer information, there is no question about that, but I find that that failure was coupled with acts of concealment.

The Clifford-Stern relationship was not trivial, insignificant or insubstantial; and because of that, and Mr. Stern's interest in Merit Insurance Company, the Clifford/Merit relationship was not trivial, insignificant or insubstantial.

Accordingly, Leatherby's Motion for Relief from Judgment is granted.

I will, in a matter of a few days, issue a written opinion, but the heart of that is obviously what I have spoken about here today.

I think it is extremely unfortunate that a case which took so long to try and involved such important issues should now be undone because of what I find to have been an impropriety at the beginning of this proceeding; and I suppose there is almost no way to tell, really, whether Mr. Clifford was, in fact, guilty of actual bias. Those things are extremely difficult to determine, but in my view the law is very clear on what is called for by an arbitrator; and for whatever reasons, some of them I think obvi-

ous, some of them I think less so, Mr. Clifford not only did not disclose, but did everything he could not to disclose, even to the point of deception.

In the face of that, it cannot be allowed to stand, an award which has its underpinnings in a defect that I find significant.

There is, I guess, some natural disinclination to undo years of hard work, and the cases talk about that; that the lack of disclosures should not be used to let a disgruntled loser find some extremely technical reason to undo the result because that result was harmful to the loser, and he suffers by virtue of it. And so, the cases are, and the opinions talk about that, and I think there is a natural hesitation to come to a result which, in effect, undoes all of that; but, gentlemen, as I heard this evidence, and as I reviewed the authorities and as I reviewed my notes, I could come to no other conclusion, and that is why I did what I did.

Of course, the Seventh Circuit will have the last word on that. I assume this decision will be appealed along with the rest of the case upstairs; and with that in mind, we will make every effort to expedite your ability to get up there. I do not know if the transcript has been prepared, but we will issue as soon as possible a written decision.

In a way, it is a sad thing to come to this result, but I do not apologize for it. I think it had to be, and that is the way it is.

MR. RIEGER: Thank you, your Honor.

MR. HOLSTEIN: Thank you, Judge.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

MERIT INSURANCE COMPANY,	)	
	)	
Plaintiff,	)	
	)	
v.	)	80 C 6758
	)	
LEATHERBY INSURANCE COMPANY,	)	
	)	
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

had in the above-entitled cause before the Honorable CHARLES P. KOCORAS, one of the Judges of said court, in his courtroom in the United States Courthouse, Chicago, Illinois on October 15, 1982 at the hour of 10:30 a.m.

APPEARANCES:

MR. ROBERT HOLSTEIN

MR. CHARLES J. O'LAUGHLIN,
appeared on behalf of the plaintiff;

MR. DONALD MC SWEENEY

MR. DONALD CASEY

MR. WILLIAM HANNAY,
appeared on behalf of the defendant.

THE CLERK: 80 C 6758, Merit Insurance Company v. Leatherby Insurance Company. Ruling on motion for reconsideration.

MR. HOLSTEIN: Good morning, your Honor, Robert Holstein on behalf of Merit Insurance Company.

MR. O'LAUGHLIN: Charles O'Laughlin on behalf of Merit Insurance Company.

THE COURT: Good morning.

MR. MC SWEENEY: Donald McSweeney on behalf of the Leatherby Insurance Company.

MR. CASEY: Donald Casey for Leatherby Insurance Company.

THE COURT: Gentlemen, I have read the pleadings you have filed, I have reviewed the case authorities, and this is what I have concluded:

This matter comes before me on the motion of Merit Insurance Company to reconsider this Court's order of September 10, 1982, to set a date for an evidentiary hearing and to set a date for oral argument under Federal Rules of Civil Procedure 59.

First, Merit contends that this Court's order of September 10, 1982 is not consonant with Section 10 of the Federal Arbitration Act, 9 U.S.C. Section 10, which sets forth the applicable grounds for vacating awards.

This Court's order, however, was based upon Section 10(b) of the Act which permits vacating an award on the ground of "evident partiality". Such an interpretation of Section 10(b) was based expressly on the Supreme Court's construction of that provision in Commonwealth Coatings Corporation v. Continental Casualty Company.

Second, Merit argues that this Court failed to apply the appropriate legal test in determining whether the facts adduced at the evidentiary hearing support the Court's decision to vacate the award. In my view, I did apply the test set forth by the Supreme Court in the Commonwealth Coatings case and in subsequent decisions by the Court of Appeals; and, particularly, those in the Seventh Circuit.

I do not read the leading cases which affect the disposition of this motion to limit the inquiry about prior relationships to pecuniary interests, for the language of those opinions do not so limit the application of the principles there described; nor, indeed, could they.

It is all too obvious that relationships founded and maintained on bases other than money can, and indeed often are, far more substantial than those characterized by the dollar sign.

As the Seventh Circuit pointed out in the U.S. Wrestling Federation case, because no authority is directly on point, and because of the infinite number of possibilities of claims for some connective basis for disqualification, it probably is necessary to consider cases of this type on a case-by-case basis.

The Seventh Circuit did not find that to be a comforting prospect, but the conclusion they reached was mandated by, as they have found, the infinite possibilities that exist.

With respect in this case to the relationship between Mr. Stern and Mr. Clifford, I would, first off, like to again state that I reject the notion attempted to be put forward by Mr. Clifford, that he operated autonomously in running the Claims Department. The other evidence in this case clearly belies that.

Secondly, it is argued that while Mr. Clifford may have developed some impressions of Mr. Stern, there is no evidence that he did so.

For Mr. Clifford to have worked under Mr. Stern for as long as he did; and, among other items characterizing the importance of that relationship, to take a polygraph examination and necessarily be evaluated in those circumstances for purposes of being retained as an employee—

which he ultimately was—and to conclude that Mr. Clifford had no impression or belief as to the type of man Mr. Stern was, and whether or not he was an honest man, is contrary to both human experience and common sense.

To reiterate a portion of my prior conclusions, the essential question is whether or not Leatherby was entitled to have knowledge of the relationship so that it could make its own determination as to the likely impact of that relationship and its effect on important credibility determinations.

Third, Merit suggests that this Court denied it due process of law by failing to permit it to speak to certain witnesses prior to the evidentiary hearing. Merit as well as Leatherby, however, were afforded the full opportunity to cross-examine and to directly examine each and every witness called by the Court to testify.

Furthermore, no restrictions whatsoever were imposed on Merit with respect to the persons that it could subpoena or call as witnesses.

Fourth, Merit contends that this Court erred by sustaining an objection to questions directed to Mr. Casey and Mr. Armiros concerning when Leatherby was informed of Mr. Clifford's prior association with Mr. Rotheiser and Mr. Stern. This Court did nothing of the kind. Ample opportunity existed for counsel to ask when Leatherby or its representatives first learned of Mr. Clifford's prior association with Mr. Stern and Mr. Rotheiser.

All of the testimony at the hearing, as well as the affidavits submitted into evidence, established when Leatherby and its counsel first learned of Mr. Clifford's prior professional relationship with Mr. Stern and Mr. Rotheiser. The evidence showed that Leatherby first learned of this in the spring of 1982.

This Court did, however, sustain objections to questions asking how or from what source Leatherby obtained such information. Those objections were sustained on the grounds of relevance, hearsay and privilege.

Fifth, Merit asserts that Mr. Clifford was not actually biased or impartial during the arbitration proceedings; and in support of that contention, Merit has submitted lengthy affidavits of the other two arbitrators, Mr. James W. Kissel and Mr. John F. Bolton.

Further, Merit observes that the award was unanimous. The Supreme Court has made it clear, however, that an award may be vacated because of an arbitrator's failure to disclose, regardless of whether the arbitrator acted in an entirely fair and impartial manner during the arbitration proceedings.

Commonwealth Coatings, in my view, stands for that proposition.

Justice White assumed in his concurrence that the plurality opinion did not question the challenged arbitrator's impartiality in the proceeding. Moreover, the Seventh Circuit has clearly stated in U.S. Wrestling Federation that an arbitration award may be set aside despite the fact that the award is unanimous by all three arbitrators if it is tainted by a duty of disclosure on the part of one. As a result, it is sufficient to vacate even if Mr. Clifford alone violated his duty to disclose.

It may well be that the award to Merit is justified based on the evidence, and it may also be that Arbitrator Clifford was not guilty of a bias, which was manifested and found its way into the award, although that is a much more illusive question; but the mandate of the law does

not permit subservience of the principle of fairness and disclosure of an important fact to the proposition that the end justifies the means.

For those reasons, the motion of Merit Insurance Company to reconsider or to vacate this Court's order of September 10, 1982, is denied. Merit's motion to set an evidentiary hearing and a date for oral argument is also denied.

I will, again, tell you, as I told you before, that there is undoubtedly some great tragedy in this case because of the fact of non-disclosure; and as I alluded a moment ago, it may well be that the award is justified in the case based on the facts, but there is, in my view, a fundamental principal involved here, and the issue is not a trivial one, nor was the relationship. I think the cases mandate—and my decision is based on that—that Mr. Clifford had an obligation—clearly had an obligation—to tell Leatherby that for about two years he and Mr. Stern officed 75 feet apart and they worked for the same company and Mr. Stern was the superior of Mr. Clifford. That was not an unimportant relationship, and it did not diminish by the passing of time.

His failure to do that, and when you couple that failure with his own conduct on this witness stand and his own conduct in connection with the submission of information to the American Arbitration Association, leads to the conclusion, first, that there was an important fact that was not disclosed—and intentionally so.

I concede that when I listened to Mr. Clifford as a witness, as pointed out in the brief for Merit, that I had some concerns and was upset at what I considered to be less than credible evidence. I will dare say I did, and I admit

it to all of you. I think the oath is a very solemn undertaking, and in my judgment Mr. Clifford was not candid with this Court on matters of some importance.

I am not, however, so impassioned by that or so blind to the fundamental questions raised by the motion, to permit that view of his credibility to dictate the results in this case. It certainly did not help Mr. Clifford and it did not help Merit Insurance Company, but that did not end the inquiry. The inquiry is clear: Was the relationship trivial or substantial? I think the Supreme Court has clearly said that, and that is the basis for my decision.

I do not know what else I can say. I sympathize, not with Leatherby—Leatherby is rejoicing now—but I sympathize with Merit. There may well have been some fraud in this case and they may well have been deprived of some profit they were entitled to make, as well as incurred some damages, but you cannot let that stand when there was such a defect in the proceedings. I am convinced not only that the decision is the right one, but that there could be no other.

That is the basis for my ruling, and in the last analysis the Seventh Circuit will speak to whether I am correct or not. That will be the result.

MR. HOLSTEIN: Thank you, Judge.

MR. CASEY: Thank you, your Honor.

MR. O'LAUGHLIN: Thank you, your Honor.

MR. MC SWEENEY: Thank you, Judge.

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APPENDIX D

UNITED STATES DISTRICT COURT,
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Name of Presiding Judge, Honorable Charles P. Kocoras

Cause No. 80 C 6758 Date September 10, 1982

Title of Cause Merit Insurance Co. -v- Leatherby Inc.

Ruling

For the reasons given in open court, the motion of defendant Leatherby Ins. Co. for relief from judgment under Fed.R.Civ.P. 60(b) is granted. The orders of this court dated November 19, 1981 and December 16, 1981 confirming the arbitration award are hereby vacated. The arbitration award of December 1, 1980 is vacated. The findings and conclusions state[d] in open court will stand in lieu of a written opinion, and no written opinion will issue.

/s/ Kocoras J.

APPENDIX E

UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

Name of Presiding Judge, Honorable Charles P. Kocoras

Cause No. 80 C 6758 Date October 15, 1982

Title of Cause Merit Insurance Co. -v- Leatherby Insurance Co.

Brief Statement of Motion ruling on mo[tion] to reconsider

Merit Insurance Company's motion to reconsider or to vacate this Court's order of September 10, 1982 is denied. Merit's motion to set for an evidentiary hearing and a date for oral argument is also denied.

/s/ *Kocoras*
Judge

APPENDIX F

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

July 12, 1983.

Before

Hon. WALTER J. CUMMINGS, Chief Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. THOMAS E. FAIRCHILD, Senior Circuit Judge

MERIT INSURANCE COMPANY,
Plaintiff-Appellant,

No. 82-2885 vs.

LEATHERBY INSURANCE COMPANY a/k/a
WESTERN EMPLOYERS INSURANCE COMPANY,
Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 80 C 6758

Judge Charles P. Kocoras

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and the case is REMANDED, with directions, in accordance with the opinion of this Court filed this date.

APPENDIX G

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

September 12, 1983

Before

Hon. WALTER J. CUMMINGS, Chief Judge
Hon. RICHARD A. POSNER, Circuit Judge
Hon. THOMAS E. FAIRCHILD, Senior Circuit Judge

MERIT INSURANCE COMPANY,
Plaintiff-Appellant,

No. 82-2885 vs.

LEATHERBY INSURANCE COMPANY a/k/a
WESTERN EMPLOYERS INSURANCE COMPANY,
Defendant-Appellee.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.

No. 80 C 6758

Charles P. Kocoras, *Judge*.

ORDER

On July 26, 1983, respondent-appellee Leatherby Insurance Company filed a petition for rehearing with suggestion for rehearing *en banc*. All of the judges of the original panel have voted to deny the petition, and none of the active members of the court has requested a vote on the suggestion for rehearing *en banc*. The petition is therefore **DENIED**.

APPENDIX H

Petitioner Leatherby Insurance Company's affiliates, which are subsidiaries of its parent corporations as named at p. ii, but excluding the subsidiaries of the affiliates, are as follows.

*The Continental Group, Inc. wholly-owns**:

CCC Canada Holding, Inc.
CCC Finanz A.G. (Switzerland)* (70-100% owned)
Continental Can Company, Inc.
Continental Energy Corporation
Continental Financial Services Company
Continental Forest Industries, Inc.
The Continental Group, Inc. (inactive)
The Continental Group (Germany) GmbH* (95-100% owned) (inactive)
The Continental Group of Europe Inc.
Continental Group Overseas Finance, N.V. (Netherland, Antilles)
Continental Power Systems, Inc.
Covent Insurance Company Limited (Bermuda)
Europemballage Corporation
Richmond Corporation (inactive)
Rock Ledge, Inc. (inactive)
The Vinoxen Company, Inc.* (80% owned)
Continental International Sales Corporation

Continental Financial Services Company wholly-owns:

Continental Equivest, Inc.
Continental Land Sales, Inc.
Continental Land Title Co.
Insurance Management Corporation of Florida
Ft. Myers Insurance Agency, Inc. (dormant)
The Life Insurance Company of Virginia
Lawyer's Title Insurance Corporation
Western Employers, Inc.

DANAC Real Estate Investment Corp. (formerly DANAC-VIRGINIA Corp.)
SEC Computer Company
Investicon, Inc.
Investors Mortgage Insurance Company
Investors Conduit Corp.
Investors Mortgage Financial Services, Inc.
Investors Mortgage Capitol Corp.
Investmor Securities Corp.

Western Employers Inc. wholly-owns*:

Western Employers Insurance Company (petitioner)
Western Risk Management, Inc.
Park View Insurance Service, Inc.
Leatherby Insurance Service, Inc. (dormant)
Leatherby Insurance Company (dormant)
Eagle Reinsurance, Ltd.* (33⅓% owned)
Hewitt, Coleman & Associates, Inc.
Hoskins and Weckerle, Inc.